

The Financial Statements Audits at the Department of Justice

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ANATOMY OF A LOST AUDIT OPINION

OMB Press Release

Dec 2, 2004

- 17 agencies meet accelerated due dates for PARS and received Unqualified Opinions
- 5 Agencies received Disclaimers

The Lost Opinion

- What happened
- Why it happened & what changed
- How we are fixing it

Background - DOJ Financial Structure

- \$29.6B in Net Costs (FY2004)
- 7 Major Bureaus, over 40 individual components
- 10 Financial Statement Entities receiving separate audits (8 of 10 were Unqualified)
- 7 core accounting systems
- 3 different audit firms

DOJ Financial Structure is Highly Decentralized

Significant authority delegated to components for:

- controls
- systems
- operations

DOJ's Track Record

- FY 2001 Unqualified
- FY 2002 Unqualified
- FY 2003 Unqualified (withdrawn)
- FY 2004 Disclaimer

Grant Reporting Deficiencies Were the Fundamental Basis for the Disclaimer

- Auditors at the grant-making entity could not rely upon financial or IT controls
 - No time to revert to massive testing of balances based on source documentation
- DOJ/Bureau could not demonstrate grant accruals were fairly presented
 - unable to support the assumptions used
- Significant issues with adequate documentation of GL adjustments related to earlier system conversion

Grants were Material to DOJ

Consolidated Statements

\$ 3.972B net costs

\$ 744M accounts payable
(primarily grant accruals)

\$ 474M advances and prepayments
(primarily grant advances)

*When OJP was disclaimed, DOJ
disclaimer followed*

DOJ Grant Reporting

- As of FY 2003, Grant Entity had:
 - 5 Straight Clean Opinions,
No Material Weakness (MW)
 - Not identified by DOJ prior to start of FY04 audit as high risk
- FY 2004
 - Disclaimer with 5 MW in FY2004 in Accounting and IT controls

From Bad to Worse. . . .

- The FY 04 findings raised uncertainties w/FY 03 grant data that could not be resolved without additional audit procedures being performed
- No time before Nov 15 to do these procedures (subsequent auditors completed this work in late spring of 2005)
- FY 03 Component Auditors withdrew their unqualified FY03 opinion, causing withdrawal of DOJ Consolidated FY03 Unqualified Opinion

What Changed between 2003 and 2004?

- Different Statement Preparation and Auditing Dynamics
- New audit firms after 5 years
- November 15th Accelerated Due Date

New Auditors Bring Fresh and Different Audit Approaches

- Questioned existing business practices and estimation assumptions
 - Basis for accrual estimates
 - Rationale for JVs and other entries
- Challenged assumptions on grantee drawdown behavior
- Conducted a full scope IT review instead of a rotational review

Impact from 2003/2004 Changes

- Fresh outlook was coupled with no pre-existing comfort level w/entity
- Need for Additional documentation
- All this translates to TIME
- Accelerated OMB Due Date meant NO EXTRA TIME in 2004

Why It Happened...Timeline

- May/June –
 - Testing began
 - First significant delays encountered, especially in IT documentation.
- June/July –
 - Agency was slow to respond to issues with data
 - Agency focused on past auditor acceptance of practices
- July –
 - Alarm sounded due to slow progress
 - Issues with documentation and support for JVs
 - Lack of adequate reconciliation of financial data, and failure to prove out accrual assumptions

Why It Happened...Timeline

- July –
 - Dept's CFO intervenes, Corrective Action Plan worked out for rest of audit in order to complete work on time
- August/September –
 - Corrective actions underway, mixed progress
 - IT testing continues long beyond initial planned completion date
- October –
 - Auditors declare IT control deficiencies are so serious that they cannot rely on control-based testing
 - Accounting Corrective Action plan halted due to reliance on system generated data, Disclaimer Issued

Observations on What Went Wrong

- Too high a comfort level, too much reliance on established procedures
- Too little self assessment
- Slow to adapt to new audit approach and areas of emphasis
- Limited visibility into contractor operations and systems by CFO and CIO
- Too little formal validation of controls

What We're Doing on Disclaimer Issues:

- FY05 Corrective Actions started last Oct 4 on both Accounting and IT issues, direct CFO and CIO oversight
- DOJ committed to Full Accounting for FY 03 and FY04, engaged auditors for opinion work for the prior years
- Mgmt validation of IT controls, auditor IT testing earlier in year, new accruals methods validated

What Are We Doing Across DOJ?

- Regular briefings with Attorney General on Financial Management progress and issues
- Establishing CFO Entity-wide Internal Evaluation and Review Function
- Identifying key reports, material balances, key risks
- Establishing process for entity-wide controls documentation and testing

And More. . . .

- Conducting more frequent Agency CFO, OIG, CIO, Audit Partners status briefings
- Leveraging well-established Program Review units in key bureaus
- Addressing Audit risk from 7 accounting systems

Key Lessons:

- Healthy self-skepticism is needed
- More Rigorous Internal Control Assessments Across Entities
Essential, including IT areas
- Must rely on controls to meet new due date

Key Lessons:

- Don't be caught, in DOD terms, “preparing to fight the last war”
 - Agency must identify its own risk areas, not just look at what auditors report as weaknesses
 - Need recurring controls reviews of strengths as well as weaknesses-
- Implement A-123***

Thank You.